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C O N F I D E N T I A L BUDAPEST 001108

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DEPARTMENT FOR EUR/CE, EB/OMA, INR/EC
TREASURY FOR ERIC MEYER, JEFF BAKER, LARRY NORTON; USEU FOR HAARSAGER

E.O. 12958: DECL: 11/19/2013
TAGS: ECON EFIN PREL HU
SUBJECT: BANKS SAY NO TO STATE ASSISTANCE...FOR NOW

REF: VIENNA 1665

Classified By: ACTING P/E COUNSELOR JON MARTINSON; REASONS 1.4 (B) AND (D)

¶1. (U) The IMF 12.5 billion euro stand-by loan to Hungary includes provisions to help increase the equity and liquidity of banks in Hungary. The "banking sector package" includes a HUF 300 billion (approx. USD 1.5 billion) Capital Base Enhancement Fund to increase banks' capital adequacy ratio to 14 percent, and a HUF 300 billion Guarantee Fund to guarantee the rollover of loans and wholesale debt securities with an initial maturity of more than 2 months and up to 5 years. In addition to other requirements, banks receiving assistance must give the state non-voting, dividend preference shares.

¶2. (U) The package has been made available to "private Hungarian banks of systemic importance," and is intended in part to ensure a level playing field within the EU, by offering support to banks in Hungary whose parents had not already received support from other EU member states. In addition, to be eligible, banks need to have warranty capital of at least HUF 200 billion (approx. USD 1 billion). The Finance Ministry announced that three banks in Hungary met the criteria - OTP Bank, Intesa Sanpaolo's CIB Bank, and Bayerische Landesbank's MKB Bank.

WE DON'T NEED THE HELP...AT LEAST NOT UNDER THE CURRENT TERMS

¶3. (SBU) The three qualifying banks have indicated, at least preliminarily, that they do not intend to take advantage of government assistance, maintaining publicly that they do not need it. For example, OTP has stated it currently maintains a liquidity buffer of EUR 1.5 billion, which means it does not have to raise money for over a year. OTP additionally points out that it can sell some of the 17 million shares it holds, which at current market prices would raise HUF 50 billion.

¶4. (C) Some analysts believe, however, that banks' tepid reaction to the program comes not from a lack of need, but from a lack of appetite for the conditions attached. OTP is advocating that the plan be modified to more closely resemble the Austrian model (reftel) as opposed to following the U.S.-UK model, which they see as overly restrictive and "assumes the bank has been mismanaged". OTP Chairman Sandor Csanyi mentioned to the Ambassador privately two primary concerns with the current plan - that shares received by the government could, under certain economic conditions, be transformed into voting shares, thus creating a risk that the bank could be nationalized in the future; and that the executive compensation provisions, which would allow the government to set compensation limits, could cause OTP to lose many qualified managers who might be unwilling to accept

major reductions in salary.

A DOUBLE EDGED SWORD

¶5. (SBU) Another reason OTP and other banks may be reluctant to accept government assistance is out of concern that it might send a signal to investors that the banks are in trouble. OTP faced a similar situation in mid-October, when the government offered state guarantees on OTP Bank's interbank lending. Although the government was quick to mention that the Hungarian banking sector is "stable and well-capitalized" and OTP immediately refused the government's offer, maintaining that "OTP's capital status and liquidity condition are extremely good", the government action added fuel to speculative rumors that OTP was in trouble, which caused its share price to drop significantly.

THROWING A PARTY BUT NOBODY'S COMING

¶6. (SBU) After having advocated for assistance for banks during negotiations with the IMF, the government now finds itself in a situation in which its relief package has been rejected by all qualifying banks. In addition, on November 17 the Parliament Budget Committee voted down the bank package. Although this will not prevent the bill from being debated or voted on, its terms must be modified to win sufficient support for passage. SzDSz caucus leader Janos Koka commented that the bill in its current form "brings back socialism by enforced nationalization."

¶7. (U) The Ministry of Finance is expected to propose modifications to the bill in the coming weeks. MOF officials hinted that the requirements may be modified to allow additional banks to qualify for assistance, but noted that no decisions on modifications have yet been made.

WALKING A FINE LINE

¶8. (C) Comment. It is likely that OTP and other banks in Hungary would be interested in receiving state capital injections provided there is limited conditionality. Given their reluctance to admit any need for capital, however, they would likely market it as helping to "level the playing field" with competitor banks whose parents received aid from their home countries. Without the assistance package or a return to normalcy in financial markets, however, a number of banks will likely reduce their growth and their lending levels - for OTP, this could include subsidiaries in Bulgaria, the Ukraine, and elsewhere. In order to help maintain the availability of credit in Hungary and the region, the government is expected to propose modifications to the package that might make it more palatable to banks. As Central Bank Governor Andras Simor points out, however, "there must be conditions".

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